Supreme Court, U.S.
FILED
SEP 22 1997
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(14)

No. 96-1470

In The
SUPREME COURT OF THE UNITED STATES
October Term, 1997

QUALITY KING DISTRIBUTORS, INC.,
Petitioner,

v.

L'ANZA RESEARCH INTERNATIONAL, INC.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF OF *AMICI CURIAE* BEAUTY AND BARBER SUPPLY INSTITUTE INC. AND SEBASTIAN INTERNATIONAL, INC., IN SUPPORT OF RESPONDENT

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INTRODUCTION AND INTEREST OF AMICI CURIAE[1]

The Beauty and Barber Supply Institute Inc. ("BBSI") is a nation-wide trade association that represents the interests of the professional beauty products industry. BBSI's approximately 1,200 members participate in all segments of the professional beauty industry, with particular emphasis on the manufacture and distribution of hair care products (such as shampoos and conditioners), skin care products (such as moisturizers and exfoliators) and beauty salon equipment. *Amicus* Sebastian International, Inc., a member of BBSI, manufactures professional hair care products. The products sold by BBSI's members are primarily sold through professional beauty salons.

For more than 90 years, BBSI has helped its members further the goals and interests of this diverse industry by providing important industry support including industry training, promotion and public education. This industry is intensely competitive, and consumers benefit from having a wide variety and array of professional beauty products from which to choose.

Many of BBSI's distributor members sell hair and beauty care products pursuant to contractual arrangements with manufacturers. While the contractual arrangements vary, often the distributors are awarded exclusive geographic territories within which to sell a manufacturer's products to professional beauty salons. In return, the manufacturer provides educational, technical and advertising support to the

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[1] All parties' written consents to the filing of this brief are simultaneously being submitted to the Clerk of the Court. This brief was not authored in whole or in part by counsel for any party. No person or entity other than *Amicus Curiae* Beauty and Barber Supply Institute Inc. made any monetary contribution to the preparation and submission of this brief.

distributor. Other BBSI members sell products both to the professional salon market and also to the retail public, again by agreement with the manufacturer.

BBSI's members are harmed by "diversion", which is the sale of products outside authorized distribution channels, *e.g.*, to unauthorized customers and/or in unauthorized territories. Diverted product can take many routes, and many BBSI members are engaged in battling diversion on numerous fronts, including the unauthorized importations of "gray market"[2] products.

Diversion is harmful in a number of ways. Sellers of diverted goods obtain "free rides" on the investment of the manufacturers and distributors by benefiting from the substantial investment the manufacturers and distributors have made in the development and marketing of these professional beauty products, without having to make any financial or creative contribution. Additionally, it dilutes the exclusivity and aura of the products painstakingly cultivated by the manufacturers and distributors.

Diversion also disserves consumers and frustrates the manufacturer's intent that consumers receive expert consultation and advice when buying their beauty care products. When consumers buy these products from authorized sellers, they receive expert counseling on which products will work best for them. Consumers who buy diverted products are deprived of such educational benefits.

Further, consumers can be harmed from the tactics sometimes used to mask diversion. For instance, some

[2] "Gray market" products are products "intended to be sold outside the United States but which are imported into this country without the consent of the owner of the United States trademark or copyright associated with the good." *Parfums Givenchy, Inc. v. C & C Beauty Sales, Inc.*, 832 F. Supp. 1378, 1382 n.1 (C.D. Cal. 1993).

diverters remove batch or identity codes, or even care instructions, from the product, in an effort to avoid detection. The absence of that information can frustrate the effectiveness of product recalls, if any prove necessary, and can expose the customer to unwarranted harm. Although such practices are not directly at issue in this case, these are key reasons behind the anti-diversion stance adopted by many BBSI members.

Moreover, consumers who buy products intended only to be sold to and used by professionals also run the risk of harming themselves. Some beauty care products contain caustic chemicals that should be handled only by those with professional training and experience.

The *Amici* thus have a vital stake in the outcome of this case. L'Anza, the respondent here, is a manufacturer member of BBSI, and the predicament faced by L'Anza is not unfamiliar to BBSI's members. Numerous BBSI members regularly face diversion situations akin to that in this case, where the L'Anza product was sold by its manufacturer for international distribution, but apparently was diverted and imported into the United States without the authority of the manufacturer and copyright owner.

BBSI and Sebastian International, Inc. urge the Court to affirm the Ninth Circuit Court of Appeals' holding. By finding the unauthorized importation of L'Anza product to constitute copyright infringement, the appellate court's holding has the fair and practical effect of preventing an economic displacement of a nature that could seriously harm BBSI's members, distributors and manufacturers of professional beauty care products.

SUMMARY OF ARGUMENT

The decision below should be affirmed. A key purpose of the Copyright Act is to encourage creative endeavors by rewarding authors for their efforts. As the Ninth Circuit has recognized, unauthorized importation impedes that goal by depriving the copyright holder of the just rewards for his or her labors. The "first sale" doctrine should not be used to frustrate the purpose of the Copyright Act where, as in the case before the Court, the conditions of sale were premised on distribution outside the United States.

Under the plain language and purpose of Section 602(a) of the Copyright Act, the importation of a copyrighted work without the authorization of the copyright owner is and should be deemed an infringement of copyright. The first sale doctrine embodied in Section 109 of the Copyright Act should not bar the copyright owner's infringement claim based on his right to exclude unauthorized importation, where, as in the instant case, the copyright owner sold the work for distribution in the foreign market.

The decision below is consistent with the legislative history of the Copyright Act and with well-reasoned opinions of this and other courts. Moreover, the Ninth Circuit's construction not only furthers the underlying policy and purpose of the Copyright Act, but also promotes competition and creates market efficiencies. This Court accordingly should affirm the Ninth Circuit Court of Appeals' judgment.

ARGUMENT

THE RULING BELOW SHOULD BE AFFIRMED, AS THE NINTH CIRCUIT PROPERLY RECOGNIZED THAT THE FIRST SALE DOCTRINE DOES NOT BAR INFRINGEMENT BY IMPORTATION OF COPYRIGHTED WORKS SOLD FOR DISTRIBUTION ABROAD.

A. Copyright Protection is Designed to Further Creative Efforts Through Financial Reward.

The copyright law derives from the constitutional provision that:

> The Congress shall have Power . . . to promote the Progress of Science and Useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.

U.S. Const., art. I, § 8, cl. 8. That provision has been repeatedly interpreted as reflecting the conviction that providing a secure economic incentive to individuals is the best way to stimulate development of "Science and Useful Arts" to the ultimate benefit of the general public. *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984).

This Court has recognized that the ultimate goal of benefiting the public is most effectively achieved by providing the author with a "special reward." *Sony Corp.*, 464 U.S. at 429. Under the U.S. system and increasingly throughout the world, the nature of such a "special reward" is primarily economic. This Court held, in one of its seminal copyright decisions, that "[t]he economic philosophy behind

the clause empowering Congress to grant patents and copyrights is the conviction that encouragement of individual effort by personal gain is the best way to advance public welfare through the talents of authors and inventors." *Mazer v. Stein,* 347 U.S. 201, 219 (1954).

The consideration that the copyright owner's creative endeavors be awarded through fair compensation is recognized in the general grant of monopoly powers to copyright owners. Thus, the Copyright Act confers certain exclusive rights on the copyright owner, including the right to reproduce copies, to prepare derivative works, and to distribute copies to the public by sale, rental, lease or lending, 17 U.S.C. § 106, as well as the right to prevent unauthorized importation of the work. 17 U.S.C. § 602.

B. The Importation Right Under Section 602 Is a Separate and Distinct Right From the Exclusive Distribution Right In Section 106

Quality King argues that the first sale doctrine in Section 109(a) of the Copyright Act, 17 U.S.C. § 109(a), should limit the importation right secured to copyright owners under Section 602(a), 17. U.S.C. § 602(a). Pet'r Br. at 12-13. In doing so, Quality King relies on the reference to Section 106 in the text of Section 602(a). *Id.* As discussed below, such an interpretation is contrary to the text of Section 602(a) and the underlying policy and Congressional intent for enacting this distinct importation right.

Section 602 of the Copyright Act provides, in pertinent part:

> (a) importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a

> work that had been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under Section 106, actionable under Section 501.

Section 106(3) of the Copyright Act provides:

> Subject to sections 107 through 120, the owner of the copyright under this title has the exclusive rights to do and to authorize any of the following:
>
> . . .
>
> (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending . . . .

The importation right in Section 602 is a separate, distinct right from the distribution right in Section 106(3). This is evident from two clear facts: (1) Congress' decision not to include the importation right of Section 602 in section 106(3), and (2) Congress' independent and separate reference to the enforcement of the importation right of Section 602 in Section 501. As Section 602 provides a separate and distinct right from the distribution right under Section 106(3), and the first sale doctrine under Section 109(a) applies only to section 106(3), Section 109(a) cannot reasonably be construed to limit a copyright owner's ability to prohibit the unauthorized importation of copies of his work under Section 602(a).

(1) Congress Created the Importation Right Under Section 602 as a Separate and Distinct "Special Reward" for Authors and Creators

The fact that Congress did not include the importation right in Section 106(3) is compelling evidence of the fact that this right is separate and distinct from those provided under Section 106. Indeed, Section 602 was created to specifically overcome the inability of the rights granted under Section 106 to apply to acts that occur outside the United States. *See* Staff of House Comm. on the Judiciary, 88th Cong., 1st Sess., Copyright Law Revision (Part 2: Discussion and Comments on Report of the Register of Copyrights on the General Revision of the U.S. Copyright Law 212 (Comm. Print 1963)); *see also* H.R. Rep. No. 1476, 94th Cong., 2d Sess. 169 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5785.

Because Section 106(3) does not expressly apply to acts outside of the United States, a copyright owner has no enforceable distribution rights under Section 106(3) with respect to actions taken outside the borders of the United States. *See Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc.*, 569 F. Supp. 47, 49 (E.D. Pa. 1983) (stating "[t]he protection afforded by the United States Code does not extend beyond the borders of this country unless the Code expressly states" that it does), *aff'd without opinion,* 738 F.2d 421 (3d Cir. 1984). It is an established legal priciple that absent specific congressional intent, domestic laws are presumed not to apply outside the United States. *See EEOC v. Arabian Am. Oil Co.*, 499 U.S. 244, 248 (1991) (stating that legislation applies only within the boundaries of the United States unless Congress has manifested a contrary intent) (quoting *Foley Bros., Inc. v. Filardo,* 336 U.S. 281, 285 (1949)).

Section 602, on the other hand, specifically addresses activities outside the United States, by prohibiting importation of copyrighted works "that have been acquired *outside the United States*." 17 U.S.C. § 602(a) (emphasis added). As such, Section 602(a) grants to copyright owners a separate and valuable right that is distinct from the exclusive and strictly domestic rights granted under Section 106.

Allowing sales of copyrighted works abroad to extinguish the distribution right gives the distribution right an extraterritorial effect. *Columbia Broadcasting Systems,* 569 F. Supp. at 49. Such construction is contrary to the established principle against extraterritorial applicability of the Copyright Act absent congressional intent. *Subafilms Ltd. v. MGM-Pathe Communications Co.*, 24 F.3d 1088, 1095 (9th Cir. 1994); *Capitol Records, Inc. v. Mercury Records Corp.*, 221 F.2d 657, 662 (2d Cir. 1955).

(2) The Language of Section 501 Provides Further Compelling Evidence that the Importation Right in Section 602 is a Separate and Distinct Right from the Distribution Right Provided in Section 106(3)

Section 501 gives copyright owners the right to sue for infringement of their exclusive rights provided under either Section 106 or Section 602. 17 U.S.C. § 501. Section 501 provides, in pertinent part,

> (a) Anyone who violates any of the exclusive rights of the copyright owner as provided by sections 106 through 118 . . . or who imports copies or phonorecords into the United States in violation of

> section 602, is an infringer of the copyright or the right of the author, as the case may be.

17 U.S.C. § 501(a). This separate reference to Section 602 provides further compelling evidence that the importation right is separate and distinct from the distribution right in 106(3). Congress' decision to have a separate reference to Section 602 manifests its intent to provide for a distinct right against unauthorized importation.

Additionally, the specific provision in Section 602 that unauthorized importations in violation of that section are actionable under Section 501 is further evidence that Congress intended to create an importation right separate from the distribution right in Section 106(3).

C. The First Sale Doctrine Applies Only If The Copyright Owner has Received "Full Value"

Section 109 of the Copyright Act, which codifies the "first sale" doctrine, provides:

> (a) Notwithstanding the provisions of Section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

Consistent with the overall aim of the Copyright Act to encourage creativity through financial reward, courts faced with the issue of whether a "first sale" has occurred so as to

exempt further disposition from the distribution right of Section 106(3), have adopted a functional analysis. As adopted by the Ninth Circuit below, and as applied in other copyright cases, courts using the functional analysis have held "that a first sale of copies or phonorecords has occurred if the disposition in question has enabled the copyright owner to realize their value." *Parfums Givenchy v. C & C Beauty Sales,* 832 F. Supp. 1378, 1389 (C.D. Cal. 1993), *citing* 1 Paul Goldstein, Copyright § 5.6.1 at 598 & n.14. As the court recognized in *C&C Beauty Sales,*

> This "full value" -- the price at which the copyright owner is willing to sell copies of his work -- depends on market conditions and, in today's global economy, varies from country to country.

C & C Beauty Sales, 832 F. Supp. at 1390. As an example, the court cited a hypothetical in which a copyright owner might be willing to sell phonorecords for $7 each in Australia, but was able to demand $10 for each record in the United States. *Id.* at 1390-91. As the court queried:

> If the phonorecords originally sold for $7 in Australia are allowed to enter the United States, where they may then be sold again for, say, $8, the United States copyright owner is forced to compete with that price, and thus is prevented from receiving the $10 to which he is entitled for each of the phonorecords originally released into the United States market.

Id. The court concluded that the first sale doctrine could not properly apply to prevent infringement actions under Section 602(a) because all relevant sections of the Copyright Act

> rest on the principle that the copyright owner is entitled to receive the full value of each copy or phonorecord upon its disposition. Applying the first sale doctrine to actions for unauthorized importation of goods manufactured and first sold abroad would violate this principle and defeat Congress' intent in enacting Section 602 (a), to expand importation protection for copyright owners so as to avoid circumvention of the distribution right.

Id. at 1391 (emphasis added).

The district court's decision in *C & C Beauty Sales* was approved by the Ninth Circuit in *Parfums Givenchy, Inc. v. Drug Emporium,* 38 F. 3d 477 (9th Cir. 1994), *cert. denied,* 514 U.S. 1004 (1995). The Ninth Circuit there described Section 602 as "ensur[ing] that a U.S. copyright owner will gain the full value of each copy sold in the United States, by preventing the unauthorized importation of copies sold abroad from being used as a means of circumventing the copyright owner's distribution rights in the United States." 38 F. 3d at 481 (citing *C & C Beauty Sales,* 832 F. Supp. at 1390-91).

If the copyright owner attempts to penetrate a foreign market by offering his work at a lower price, he has indeed

received the full value of the work if the product is actually sold within the foreign market. A copyright owner is unfairly deprived of his rightful recompense if the articles lawfully marketed in the United States must compete with articles distributed in foreign markets and thereafter imported. Section 602(a)'s prohibition protects the copyright owner from such injustice, a result consistent not only with the intended scope of the Copyright Act, but also consistent with sound competition principles.[3]

(1) Authors and Creators Rely on the "Special Reward" provided by Congress in Enacting Section 602 to Realize the Full Value of their Copyrighted Works

As noted above, Section 602 was adopted because the importation of copies from outside the United States was undermining the exclusive rights guaranteed U.S. authors and creators in Section 106(3). As a result, rights holders could not control the distribution of copies distributed through authorized channels within the United States. In effect, copyright owners were deprived of the "full value" to which they were entitled for the copies sold within the United States, even though the imported copies may have been the subject of a valid first sale.

(2) Members of *Amicus* BBSI Rely Heavily on the Importation Right to Ensure Adequate Realization of the "full value" of their Products

Members of *Amicus* BBSI research, formulate and distribute high quality hair care products which are sold exclusively through professional beauty and barber salons ("authorized distribution channels"). BBSI members

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[3] *See* discussion in Sections D & E, *infra.*

typically invest heavily in advertising, training and education in the United States market, to create and maintain a reputation for their high quality products available only through the authorized channels of distribution.

Many members distribute their products in the United States through authorized distributorships formed along territorial lines. Foreign markets are traditionally handled separately, and any transshipment across foreign borders, or from foreign markets into the United States, is typically not authorized. As L'Anza did in this case, some manufacturers of professional beauty products discount foreign sales by as much as 40% below the prices that may be charged to their U.S. distributors.

Such heavy discounts reflect the fact that the manufacturer's training, promotion and consumer education activities focus on the United States market. Foreign distributors, on the other hand, generally must promote the products and educate consumers on their own, without the benefit of the manufacturer's U.S. advertising and promotional activities. Consequently, the prices to these foreign distributors do not reflect the manufacturer's training, education and advertising activities in the authorized channels of distribution in the United States.

As a result, the manufacturer only makes these sales to foreign distributors on the reliance that they would never be imported into the United States. This is because if a foreign distributor, or someone who has purchased such products from a foreign distributor, imports the products into the United States, the manufacturer is forced to compete with its own reimported products, and is then deprived of its right to obtain the "full value" of its copyright with regard to sales in the United States. This is in fact what happened in the present case. The Ninth Circuit's opinion should be affirmed

in order to prevent such an unfair consequence and to give full meaning to the purpose and policy of the Copyright Act.

D. Quality King's and *Amicus* AFTA's Claims of Unfairness or Restraint of Trade are Without Merit

Any concern over restraints of trade underlying the application of the first sale doctrine, as codified in Section 109, to the sale of copyrighted works abroad is wholly unwarranted. *See* Pet'r Br. at 20-21. The original concerns which fostered adoption of the first sale doctrine involved the perception that a copyright owner's ability to maintain resale prices might be anticompetitive. H.R. Rep. No. 1476, 94th Cong., 2d. Sess. 64 (1976), *reprinted in* 1976 U.S.C.C.A.N. 5659, 5693 ("[t]hus, for example, the outright sale of an authorized copy of a book frees it from any copyright control over its resale price or other conditions of its future disposition").

Today, economists and legal scholars generally recognize that vertical restraints, such as exclusive distributorships (and even resale price maintenance) are not anticompetitive and in fact lead to increased sales. *See Continental T.V., Inc., v. GTE Sylvania Inc.*, 433 U.S. 36 (1977). Elimination of unauthorized parallel imported goods, or "gray market" products, is procompetitive because it protects a U.S. copyright owner from competing against copies of its own work in a manner that disrupts the rational marketing strategy of the copyright owner. *See* Christopher A. Mohr, *Gray Market Goods and Copyright Law: An End Run Around Kmart v. Cartier,* 45 Cath. U. L. Rev. 561, 606-07 (1996).

If the first sale doctrine were held to apply to sales of copyrighted works abroad, then economic principles would compel that the copyright owner simply limit, or eliminate,

distribution of its work abroad -- which harms competition and results in irrational behavior. *See* Lexecon Inc., *The Economics of Gray Market Imports* pp. 18 & 26-30 (1985) (stating intrabrand competition injures distribution networks). Therefore, the concerns over resale price maintenance that were behind the adoption of Section 109 do not apply to enforcing a copyright owner's right to halt the unauthorized importation of copyrighted works.

E. This Court has Repeatedly Recognized That Vertical Territorial Restraints That Have the Same Effect as Restricting Unauthorized Imports Are Procompetitive

The ability to prevent unauthorized importation of copyrighted works, a protection granted by the importation right under Section 602(a), is in fact procompetitive because it creates efficiencies and other public benefits that ensure vigorous interbrand competition.

In reviewing various challenges made under the antitrust laws to restrictive distributorship arrangements in the United States, this Court has found that such restrictions generally stimulate interbrand competition, and thus are "reasonable" restraints. *See Continental T.V., Inc., v. GTE Sylvania Inc.*, 433 U.S. 36, 51-54 (1977); *see also* Robert H. Bork, *The Antitrust Paradox* at 288-91 (1978) (arguing for the legitimacy of all vertical restraints, including resale price restrictions).

Territorial restrictions limit a distributor's freedom to sell by prohibiting it from selling outside an assigned territory, thereby eliminating "intrabrand" competition.[4] In

[4] Intrabrand competition is the competition between the distributors -- wholesale or retail -- of the product of a particular manufacturer. In contrast, interbrand competition is the competition among various manufacturers of the same kind of product and "is the primary concern of antitrust law." *Continental T.V., Inc., v. GTE Sylvania Inc.*, 433 U.S. 36, 52 n.19 (1977).

Continental T.V., this Court recognized that such territorial restrictions "promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products." 433 U.S. at 54.[5] In addition, geographical restrictions operate as incentives for distributors to invest capital and effort in cultivating an exclusive market, to increase their advertising and marketing efforts, and to provide better consumer education, without the fear of free-riders. That in turn increases output, thus promoting competition among brands. *Id.* at 55.

That effect is readily apparent in the professional beauty products market, where many high quality product manufacturers vigorously compete for the consumer's dollars. For this additional reason, the Ninth Circuit's decision should be affirmed.

F. Sections 109 and 602 Should be Harmonized to Encourage Fair Reward to the Copyright Owner

The interest to be protected by the Copyright Act -- encouraging creativity by means of adequate financial reward, to the ultimate benefit of the public, is best served by reading Sections 109 and 602(a) of the Copyright Act in tandem, such that the first sale doctrine can be invoked only

[5] *See also Crane & Shovel Sales Corp. v. Bucyrus Erie Co.*, 854 F.2d 802, 810 (6th Cir. 1988) (creating exclusive territory may enhance manufacturer's ability to compete); *Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1356 (9th Cir. 1982) (purpose of territorial restrictions to enter new markets and promote wider availability of products found reasonable); *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 297-98 (5th Cir. 1981) (reversing jury verdict for plaintiff where restriction sought to increase product advertising, and interbrand competition was increased); *Clairol, Inc. v. Boston Discount Ctr.*, 608 F.2d 1114, 1125 (6th Cir. 1979) (upholding customer restrictions designed to promote consumer safety and protect product goodwill).

if the copyright owner has received "full value" for the work. The copyright owner thus should have the right to challenge, as infringement, the unauthorized importation of copyrighted goods.

CONCLUSION

For the foregoing reasons, and to protect the underlying purpose and intent of the Copyright Act -- encouraging creativity by means of adequate financial reward -- *Amici* respectfully urge that this Court affirm the United States Court of Appeals for the Ninth Circuit's ruling.

Respectfully submitted,

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